

free-market economy has come to be regulated in minute and expensive detail, with the costs born largely by consumers. Citizens have lost much of the economic liberty their ancestors esteemed.

American traditions and political pressures have kept the government from totally destroying all private property rights. But the Constitution, which formerly served to guarantee economic liberties, no longer provides much if any substantial protection. One may well doubt whether the economic dynamism that made the average American rich by world standards will prove permanently compatible with a constitutional regime so permissive of governmental intrusion into economic affairs.

But the Constitution can be changed, as it has been changed before. In 1865 the Constitution gave the slaves freedom from their masters. We can hope that someday the Constitution will be changed again to give all Americans economic freedom from our masters in Washington.

## Nine Myths About the Crash

*Murray N. Rothbard*

Ever since Black, or Meltdown, Monday October 19th, the public has been deluged with irrelevant and contradictory explanations and advice from politicians, economists, financiers, and assorted pundits. Let's try to sort out and rebut some of the nonsense about the nature, causes, and remedies for the crash.

*Myth One:* It was not a crash, but a "correction."

Rubbish. The market was in a virtual crash state since it started turning down sharply from its all-time peak at the

end of August. Meltdown Monday simply put the seal on a contraction process that had gone on since early September.

*Myth Two:* The crash occurred because stock prices had been “overvalued,” and now the overvaluation has been cured.

This adds a philosophical fallacy to Myth #1. To say that stock prices fell because they had been overvalued is equivalent to the age-old fallacy of “explaining” why opium puts people to sleep by saying that it “has dormitive power.” A definition has been magically transmuted into a “cause.” By definition, if stock prices fall, this means that they had been previously overvalued. So what? This “explanation” tells you nothing about why they were overvalued or whether or not they are “over” or “under” valued now, or what in the world is going to happen next.

*Myth Three:* The crash came about because of computer trading, which in association with stock index futures, has made the stock market more volatile. Therefore computer trading and/or stock index futures, should be restricted/outlawed.

This is a variant of the scapegoat term “computer error” employed to get “people errors” off the hook. It is also a variant of the old Luddite fallacy of blaming modern technology for human error and taking a crowbar to wreck the new machines. People trade, and people program computers. Empirically, moreover, the “tape” was hours behind the action on Black Monday, and so computers played a minimal role. Stock index futures are an excellent new way for investors to hedge against stock price changes, and should be welcomed instead of fastened on—by its competitors in the old-line exchanges—to be tagged as the fall guy for the crash. Blaming futures or computer trading is like shooting the messenger—the markets—that brings bad financial news. The acme of this reaction was the threat—and sometimes the reality—of

forcibly shutting down the exchanges in a pitiful and futile attempt to hold back the news by destroying it. The Hong Kong exchange closed down for a week to try to stem the crash and, when it reopened, found that the ensuing crash was far worse as a result.

*Myth Four:* A major cause of the crash was the big trade deficit in the U.S.

Nonsense. There is nothing wrong with a trade deficit. In fact, there is no payment deficit at all. If U.S. imports are greater than exports, they must be paid for somehow, and the way they are paid is that foreigners invest in dollars, so that there is a capital inflow into the U.S. In that way, a big trade deficit results in a zero payment deficit.

Foreigners have been investing heavily in dollars—in Treasury deficits, in real estate, factories, etc.—for several years, and that's a good thing, since it enables Americans to enjoy a higher-valued dollar (and consequently cheaper imports) than would otherwise be the case.

But, say the advocates of Myth #4, the terrible thing is that the U.S. has, in recent years, become a debtor instead of a creditor nation. So what's wrong with that? The United States was in the same way a debtor nation from the beginning of the republic until World War I, and this was accompanied by the largest rate of economic and industrial growth and of rising living standards, in the history of mankind.

*Myth Five:* The budget deficit is a major cause of the crash, and we must work hard to reduce that deficit, either by cutting government spending, and/or by raising taxes.

The budget deficit is most unfortunate, and causes economic problems, but the stock market crash was not one of them. Just because something is bad policy doesn't mean that

all economic ills are caused by it. Basically, the budget deficit is as irrelevant to the crash, as the even larger deficit was irrelevant to the pre-September 1987 stock market boom. Raising taxes is now the favorite crash remedy of both liberal and conservative Keynesians. Here, one of the few good points in the original, or "classical," Keynesian view has been curiously forgotten. How in the world can one cure a crash (or the coming recession), by raising taxes?

Raising taxes will clearly level a damaging blow to an economy already reeling from the crash. Increasing taxes to cure a crash was one of the major policies of the unlamented program of Herbert Hoover. Are we longing for a replay? The idea that a tax increase would "reassure" the market is straight out of Cloud Cuckoo-land.

*Myth Six:* The budget should be cut, but not by much, because much lower government spending would precipitate a recession.

Unfortunately, the way things are, we don't have to worry about a big cut in government spending. Such a cut would be marvelous, not only for its own sake, but because a slash in the budget would reduce the unproductive boondoggles of government spending, and therefore tip the social proportion of saving/consumption toward more saving and investment.

More saving/investment in relation to consumption is an Austrian remedy for easing a recession, and reducing the amount of corrective liquidation that the recession has to perform, in order to correct the malinvestments of the boom caused by the inflationary expansion of bank credit.

*Myth Seven:* What we need to offset the crash and stave off a recession is lots of monetary inflation (called by the euphemistic term "liquidity") and lower interest rates. Fed chair-

man Alan Greenspan did exactly the right thing by pumping in reserves right after the crash, and announcing that the Fed would assure plenty of liquidity for banks and for the entire market and the whole economy. (A position taken by every single variant of the conventional economic wisdom, from Keynesians to “free marketeers.”)

In this way, Greenspan and the federal government have proposed to cure the disease—the crash and future recession—by pouring into the economy more of the very virus (inflationary credit expansion) that caused the disease in the first place. Only in Cloud Cuckoo-land, to repeat, is the cure for inflation, more inflation. To put it simply: the reason for the crash was the credit boom generated by the double-digit monetary expansion engineered by the Fed in the last several years. For a few years, as always happens in Phase I of an inflation, prices went up less than the monetary inflation. This, the typical euphoric phase of inflation, was the “Reagan miracle” of cheap and abundant money, accompanied by moderate price increases.

By 1986, the main factors that had offset the monetary inflation and kept prices relatively low (the unusually high dollar and the OPEC collapse) had worked their way through the price system and disappeared. The next inevitable step was the return and acceleration of price inflation; inflation rose from about 1% in 1986 to about 5% in 1987. As a result, with the market sensitive to and expecting eventual reacceleration of inflation, interest rates began to rise sharply in 1987. Once interest rates rose (which had little or nothing to do with the budget deficit), a stock market crash was inevitable. The previous stock market boom had been built on the shaky foundation of the low interest rates from 1982 on.

*Myth Eight:* The crash was precipitated by the Fed’s unwise tight money policy from April 1987 onward, after which the

money supply was flat until the crash.

There is a point here, but a totally distorted one. A flat money supply for six months probably made a coming recession inevitable, and added to the stock market crash. But that tight money was a good thing nevertheless. No other school of economic thought but the Austrian understands that once an inflationary bank credit boom has been launched, a corrective recession is inevitable, and that the sooner it comes, the better.

The sooner a recession comes, the fewer the unsound investments that the recession has to liquidate, and the sooner the recession will be over. The important point about a recession is for the government not to interfere, not to inflate, not to regulate, and to allow the recession to work its curative way as quickly as possible. Interfering with the recession, either by inflating or regulating, can only prolong the recession and make it worse, as in the 1930s. And yet the pundits, the economists of all schools, the politicians of both parties, rush heedless into the agreed-upon policies of: Inflate, and Regulate.

*Myth Nine:* Before the crash, the main danger was inflation, and the Fed was right to tighten credit. But since the crash, we have to shift gears, because recession is the major enemy, and therefore the Fed has to inflate, at least until price inflation accelerates rapidly.

This entire analysis, permeating the media and the Establishment, assumes that the great fact and the great lesson of the 1970s, and of the last two big recessions, never happened: i.e., inflationary recession. The 1970s have gone down the Orwellian memory hole, and the Establishment is back, once again, spouting the Keynesian Phillips Curve, perhaps the greatest single and most absurd error in modern economics.

The Phillips Curve assumes that the choice is always either more recession and unemployment, or more inflation.

In reality, the Phillips Curve, if one wishes to speak in those terms, is in reverse: the choice is either more inflation and bigger recession, or none of either. The looming danger is another inflationary recession, and the Greenspan reaction indicates that it will be a whopper.

## The Crash Commission Report

*Ron Paul*

**T**he crash of 1929, and the depression of the 1930s, entrenched the welfare-warfare state. Intellectuals, taking their cue from government propagandists, wrongly blamed the free market and the gold standard for the disaster. In a variation on the same theme, they are blaming the October 19 crash on insufficient government regulations.

Most prominent among the various stock market study commissions is the president's. But its recommendations are disappointing for anyone who values free markets. The stock market wasn't too impressed either. When the commission released its 340-page report, the Dow promptly fell 140 points.

The president's commission missed the true lessons of the crash—that Federal Reserve inflation causes the business cycle of booms and busts—and its recommendation for more regulation will only make matters worse.

The president had appointed Nicholas Brady, chairman of Dillon Read and an especially well-connected member of the Eastern Establishment, to head the commission. Also on it was John Opel, chairman of the New York Federal Reserve Bank, where the report was actually written.